

Supermarket Update

Part I: Weakest result of the quarter goes to...

Food Retail

Main takeaways:

- The drop in food prices is not leading to a recovery in the volume of the consumption basket, so that category disinflation should negatively impact the sector's Same Store Sales;
- Carrefour is expected to report the weakest result in the industry, with another quarter of net loss;
- With the slowdown in organic openings, we do not believe Assaí will achieve its guidance of R\$100bn in revenues by 2024;
- We are updating our outlook for Assaí and Carrefour, with tougher assumptions for the short term. We cut our target price to R\$17 and R\$13, respectively.

Carrefour Brasil will be the first company in the sector to release its Q2 results on Tuesday (July 25). Assaí and Pão de Açúcar will publish their figures soon after, on Wednesday (July 26). Grupo Mateus will be the last supermarket to report its balance sheet, only on August 9.

In this first part of the supermarket update report, we will deepen the analysis on the two largest companies in the sector, Carrefour and Assaí. In the second part of the report (to be released soon), we will analyze Pão de Açúcar and Grupo Mateus.

First, we need to understand two major topics that should impact the largest players in the sector.

Topic I: Food retail inflation below 3%

Historically, fluctuations in food prices are common, however, the last 3 years have been marked by **two major atypical events** (*if we can define it that way*): a pandemic and a war.

Faced with an unregulated production chain and a continuously growing demand, consumers in Brazil (*and also in the world*) experienced an unbridled increase in food prices - which weighed heavily on the consumption basket during the period.

With the normalization of the supply and demand chain and the appreciation of the real against the dollar, **we have witnessed a continuous process of deflation in the food at home category** - a movement that has become clear, mainly, over the last 6 months (see Figure 1).

Released by IBGE on a monthly basis, **the accumulated inflation of the "Food at home" category declined more than the general inflation in 2023**. It is worth remembering that, at the end of 2022, food inflation was 2x higher than the general

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Company

ASA13 BZ Equity

Buy

Price: R\$ 12,14 (July 19, 2023)

Target Price 12M: R\$ 17,00

CRFB3 BZ Equity

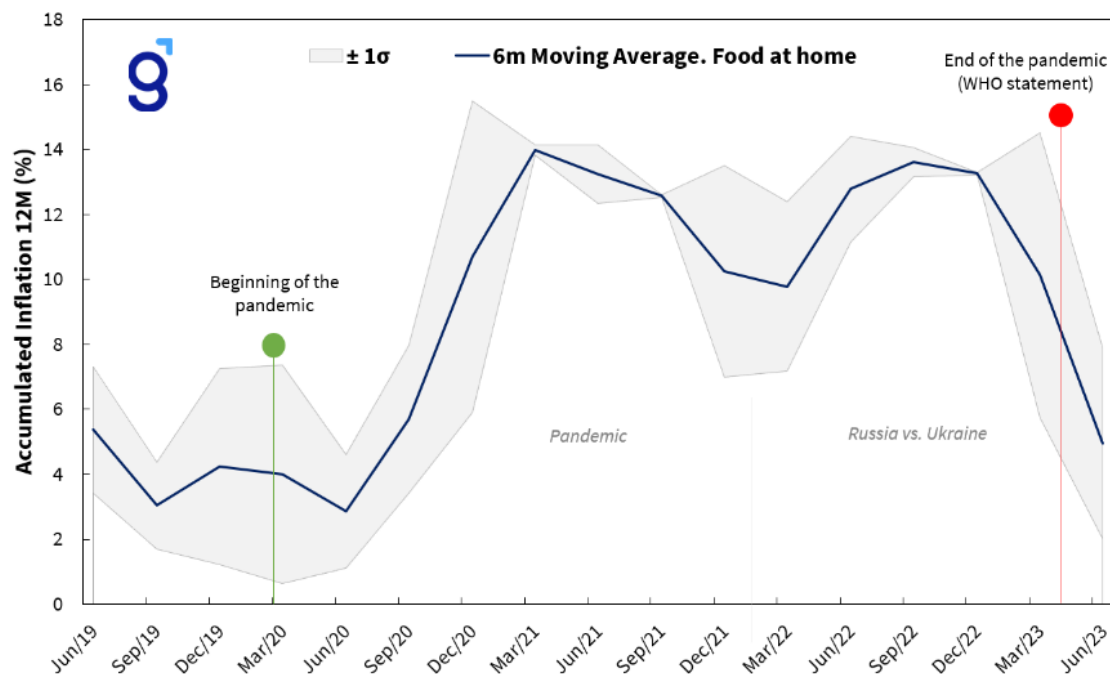
Neutral

Price: R\$ 10,70 (July 19, 2023)

Target Price 12M: R\$ 13,00

IPCA. By the end of the 1st half of 2023, inflation in this category was even lower than the general index (0.9x to be exact).

Graph 1: Prepared by Genial from IBGE data.



Ceteris Paribus, the fall in commodity prices (soybeans, corn and wheat) in the international market is a dynamic that should continue to favor food category inflation below the 5% threshold in 2023 (Est. Genial).

Volume should pressure Same Store Sales (SSS). While food disinflation is a positive move for the consumer's pocket, we do not believe there will be a volume recovery (*i.e. more items in the basket*) in 2023.

Without compensation in volume, the dynamics of lower inflation should only normalize the consumption chain in the short term, with a consumer trade up between the *atacarejo* and supermarket formats - the latter gaining more space in the new scenario.

From here, we understand that food retail players should present an **SSS** well below the consolidated one in recent months - **sometimes even negative** (as should be the case of Carrefour and Assaí this quarter).

Topic II: B2B buying pattern has changed

Between 2020 and 2022, with food inflation at a high level (*i.e. > 10% apr*), it made sense for the processing/retail public to 'overstock' products, in order to circumvent a price increase on the shelves, which happened continuously over the months.

In the face of cooling food inflation, the B2B (Business to Business) consumer takes a different consumption stance, stocking at a lower level than normal, in order to take advantage of the reduction in prices on the shelves.

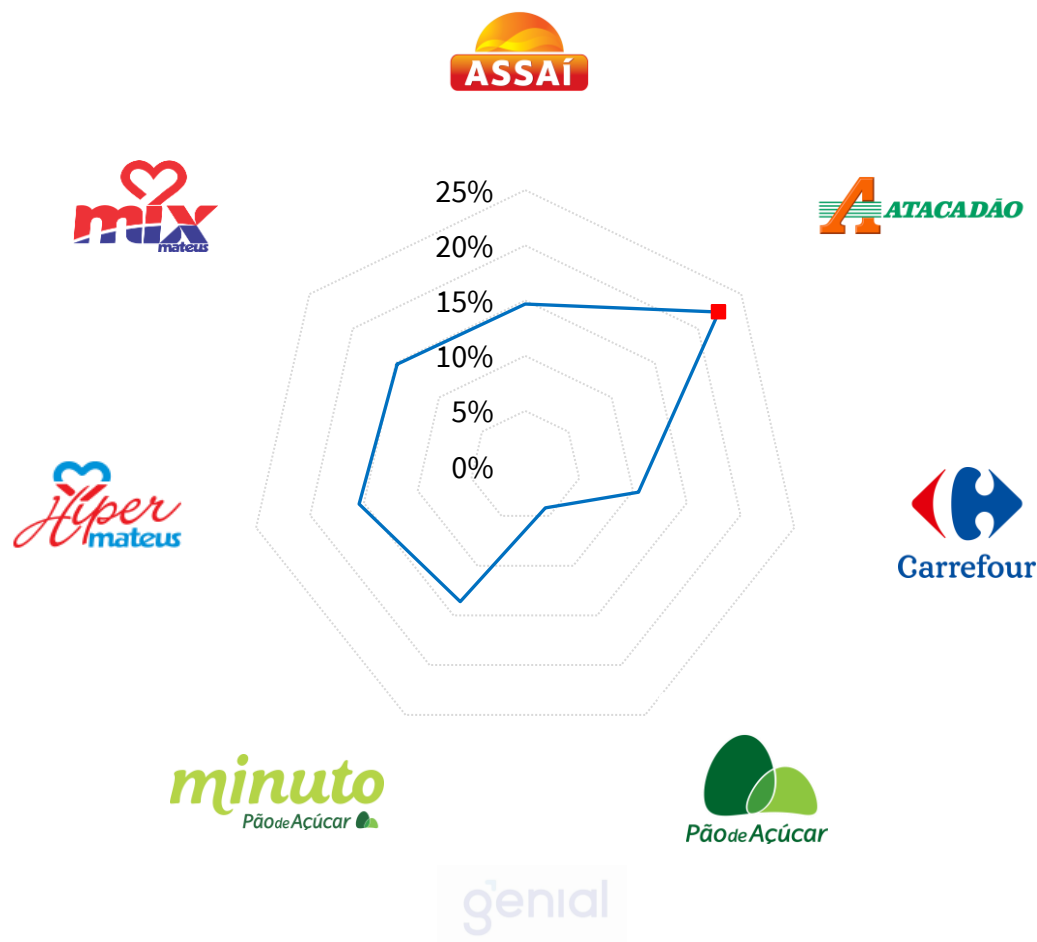
CARREFOUR REVIEW (CRFB3)

Part 1: 2Q23 estimates

In your take, this should be the worst quarter of 2023 for Carrefour. Among the players listed in Brazil, the group has the toughest comps, as the retailer posted the highest Same Store Sales in the sector in Q2 2022 (see Figure 2).

Figure 2: Consolidated view of SSS in Q2 2022.

Same Store Sales (%) | 2Q22 Outlook



Volume should pressure Same Store Sales (SSS). While food disinflation is a positive move for the consumer's pocket, we do not believe there will be a volume recovery (*i.e. more items in the basket*) in 2023. As Carrefour is the player most exposed to B2B, especially for the retail public, the change in consumption patterns (see Topic 1) should generate a slowdown in Atacadão's sales pace. And, considering that the food disinflation dynamics (see Topic 2) still does not bring a volume and/or flow recovery to the group's stores, we see that the retailer will need to deal with a "storm" of operational deleveraging this quarter.

All BIG Group conversions have already been finalized this quarter. In total, we should see 15 conversions this quarter (13 BIG and 2 TodoDia). As part of these stores were closed throughout the quarter, we should still see the negative impact of undiluted fixed expenses in the period. On the positive side the worst is over. The maturation of these stores over the next few quarters should stop the bleeding of profitability experienced by the group.

We do not believe that Carrefour will avoid a negative Same Store Sales this quarter.

In our estimate, Atacadão should show a negative indicator of -7.7% y/y (vs. SSS of 22.4% in 2Q22) and Varejo of -4.2% y/y (vs. SSS of 10.5% in 2Q22). We project the group's **gross revenue at R\$29.33bn** (Cash & Carry R\$19.18bn; Retail R\$8.00bn; Sam's R\$1.43bn), up 10.8% y/y.

We expect another quarter of weak profitability, both on a year-over-year and sequential basis. In our estimate, only Sam's is expected to gain slight operating margin traction (+55bps y/y), while Atacadão and Varejo are expected to lose -132bps and -390bps of EBITDA margin, respectively.

We do not expect the dynamics for Banco Carrefour (CSF) to be very different from what it presented in Q1 this year. The group continues to migrate the credit portfolio from BIG to CSF, so we expect, on a sequential view, that delinquencies should remain at a similar level to 1Q23.

Table 1: Genial estimates for Carrefour in 2Q23.

CASH & CARRY	2Q23 E	2Q22 C	% y/y bps	1Q23 C	% q/q bps
Gross Sales	19.188	18.260	5,1%	18.078	6,1%
Same Store Sales (%)	-7,7%	22,4%	-	5,7%	-
Net Revenue	17.255	16.623	3,8%	16.274	6,0%
COGS	(14.809)	(14.283)	3,7%	(13.775)	7,5%
Gross profit	2.446	2.340	4,5%	2.499	-2,1%
% Gross margin	14,2%	14,1%	10 bps	15,4%	-118 bps
Adj. EBITDA	920	1.106	-16,9%	916	0,4%
% Adj. EBITDA margin	5,3%	6,7%	-132 bps	5,6%	-30 bps

VAREJO (INC. BIG)	2Q23 E	2Q22 C	% y/y bps	1Q23 C	% q/q bps
Gross Sales (exc. gasoline)	7.854	7.307	7,5%	6.879	14,2%
Gasoline	708	917	-22,8%	811	-12,7%
Same Store Sales (%)	-6,0%	10,5%	-157,0%	5,7%	-1170 bps
Net Revenue	7.692	7.383	4,2%	6.917	11,2%
COGS	(5.834)	(5.673)	2,8%	(5.227)	11,6%
Gross profit	1.858	1.710	8,7%	1.690	10,0%
% Gross margin	24,2%	23,2%	100 bps	24,4%	-27 bps
Adj. EBITDA	140	423	-66,8%	143	-1,8%
% Adj. EBITDA margin	1,8%	5,7%	-390 bps	2,1%	-24 bps
SAM'S	2Q23 E	2Q22 C	% y/y bps	1Q23 C	% q/q bps
Gross Sales	1.444	-		1.353	6,7%
Same Store Sales (%)	-	-		-	-
Net Revenue	1.274	-		1.194	6,7%
COGS	(1.018)	-		(957)	6,4%
Gross profit	256	-		237	7,8%
% Gross margin	20,1%	-		19,9%	20 bps
Adj. EBITDA	62	-		52	20,2%
% Adj. EBITDA margin	4,9%	-		4,3%	55 bps
BANCO CARREFOUR (CSF)	2Q23 E	2Q22 C	% y/y bps	1Q23 C	% q/q bps
Net operating revenues	1.209	1.057	14,4%	1.124	7,6%
Risk charges	(731)	(513)	42,5%	(740)	-1,2%
Gross profit	478	544	-12,1%	384	24,6%
% Gross margin	39,6%	51,5%	-	34,2%	540 bps
Adj. EBITDA	159	290	-45,0%	44	262,2%
% Adj. EBITDA margin	13,2%	27,4%	-	3,9%	-
CONSOLIDATED GROUP	2Q23 E	2Q22 C	% y/y bps	1Q23 C	% q/q bps
Gross Sales	29.193	26.483	10,2%	27.121	7,6%
Same Store Sales (%)	(2.972)	(2.477)	20,0%	(2.736)	8,6%
Net Revenue	26.221	24.006	9,2%	24.385	7,5%
COGS	(21.182)	(19.439)	9,0%	(19.581)	8,2%
Gross profit	5.039	4.567	10,3%	4.804	4,9%
% Gross margin	19,2%	19,0%	19 bps	19,7%	-48 bps
EBIT	785	1.314	-40,2%	876	-10,4%
% EBIT margin	3,0%	5,5%	-248 bps	3,6%	-60 bps
Depreciation and Amortization	(495)	(384)	29,0%	(494)	0,3%
Adj. EBITDA	1.294	1.710	-24,3%	1.039	24,5%
% Adj. EBITDA margin	4,9%	7,1%	-219 bps	4,3%	67 bps
Net financial expenses	(737)	(400)	84,4%	(756)	-2,5%
Income Tax	(146)	(224)	-35,0%	(232)	-37,2%
Net Income	(97)	690	-114,1%	(112)	-13,3%
% Net margin	-0,4%	2,9%	-325 bps	-0,5%	9 bps

Part II: New estimates

Considering the **(I)** increased industry competition in the southeast region, **(II)** the strengthening of regional players, **(III)** the impact of food disinflation and **(IV)** the longer payback from the integration of Grupo BIG into Carrefour than initially expected, we are updating our outlook for the group, giving a pessimistic tone for the short term.

With further pressure from operational deleveraging, we revise our 2023 and 2024 net profit estimate by -55% and -6% from the previous estimate (see Table 2). On our valuation, **CRFB3 trades at a 2024E P/E of 13.0x.**

Assuming a cost of equity (Ke) of 15.2%, a perpetuity growth (g) of 3.0%, and through a discounted cash flow (DCF), **we are cutting the target price from R\$17 to R\$13** - upside of 23% from the price on 19/Jul. Given the weak recovery outlook in the near term, we reiterate our HOLD recommendation for Carrefour group shares.

		Cost of Equity (Ke)				
		12,2%	13,7%	15,2%	16,7%	18,2%
g	1,0%	13,8	13,1	12,5	12,0	11,6
	2,0%	14,3	13,5	12,8	12,2	11,8
	3,0%	14,9	13,9	13,1	12,5	12,0
	4,0%	15,6	14,5	13,6	12,8	12,2
	5,0%	16,6	15,2	14,1	13,2	12,6

		Cost of Equity (Ke)				
		12,2%	13,7%	15,2%	16,7%	18,2%
g	1,0%	29%	23%	17%	12%	8%
	2,0%	34%	26%	20%	14%	10%
	3,0%	39%	30%	23%	17%	12%
	4,0%	46%	35%	27%	20%	14%
	5,0%	55%	42%	32%	24%	17%

With no standard rate even defined, **we are not yet incorporating any impact of the Tax Reform** - approved in Congress on Friday (7/Jul) and currently under discussion in the Senate.

What tax benefit is Carrefour exposed to? Special compensation regime. The Group has distribution centers in different states, where it receives goods with prepaid ICMS and ICMS-ST (Tax Replacement). Part of these goods are sent to other states, allowing the group to recover the prepaid ICMS and ICMS-ST amounts.

In 2022, the company recognized a tax incentive (ICMS subsidy - Law No. 12,973/14) of R\$ 270 million, **reducing the effective rate to 25% in the year**. In data from 1Q23, the group has R\$ 5.73 billion in taxes that it expects to recover over the next 10 years (inc. ICMS, ICMS-ST and PIS/COFINS). Of this amount, the expectation is to recover R\$ 1.91 billion in the next 12 months.

Table 2: Genial estimates for Carrefour in 2023, 2024 and 2025.

Consolidated group	2022	2023 E			2024 E			2025 E		
	Consolidated	New	Old	% Change	New	Old	% Change	New	Old	% Change
Gross Sales	108.049	121.243	133.450	-9,1%	133.399	153.751	-13,2%	144.989	168.946	-14,2%
Same Store Sales (%)	-	12,2%	20,2%	-798 bps	12,9%	10,7%	226 bps	7,1%	5,6%	158 bps
Net Revenue	97.389	109.060	125.450	-13,1%	119.974	144.449	-16,9%	130.405	158.514	-17,7%
COGS	(77.739)	(87.512)	(100.867)	-13,2%	(96.276)	(115.790)	-16,9%	(104.627)	(127.079)	-17,7%
Gross profit	19.649	21.549	24.583	-12,3%	23.698	28.660	-17,3%	25.778	31.435	-18,0%
% Gross margin	20,2%	19,8%	19,6%	16 bps	19,8%	19,8%	-9 bps	19,8%	19,8%	-6 bps
EBIT	4.933	4.343	6.250	-30,5%	5.172	7.766	-33,4%	6.369	9.115	-30,1%
% EBIT margin	5,1%	4,0%	5,0%	-100 bps	4,3%	5,4%	-107 bps	4,9%	5,8%	-87 bps
Depreciation and Amortization	(1.671)	(1.991)	(1.994)	-0,2%	(2.076)	(2.099)	-1,1%	(2.179)	(2.230)	-2,3%
Adj. EBITDA	6.623	6.076	7.993	-24,0%	7.422	10.062	-26,2%	8.506	11.294	-24,7%
% Adj. EBITDA margin	6,8%	5,6%	6,4%	-80 bps	6,2%	7,0%	-78 bps	6,5%	7,1%	-60 bps
Net financial expenses	(2.261)	(3.054)	(4.573)	-33,2%	(2.788)	(5.247)	-46,9%	(2.779)	(5.360)	-48,1%
Income Tax	(674)	(658)	(621)	5,9%	(596)	(630)	-5,3%	(898)	(939)	-4,4%
Net Income	1.998	632	1.056	-40,2%	1.788	1.889	-5,3%	2.693	2.817	-4,4%
% Net margin	2,1%	0,6%	0,8%	-26 bps	1,5%	1,3%	18 bps	2,1%	1,8%	29 bps

ASSAÍ REVIEW (ASAÍ3)

Part I: 2Q23 estimates

Like Atacadão, Assaí should not escape the change in B2B consumer behavior (see topic 2), however, we see a softer impact than in its peer, given Assaí's greater exposure to the processing and user segment of this industry.

No organic expansion in the quarter. Between April and June, Assaí converted 5 stores (ex hipermercado Extra). Thus, 23 stores remain to be opened in the 2nd half of 2023 (15 organic and 8 conversions).

With a net addition of 50 stores in the last 12 months, totaling 270 units, we expect Assaí's gross revenue growth to be positively impacted by these openings. We estimate a **gross revenue of R\$17.65bn (+21.5% y/y) and a negative SSS of -1.5% y/y**.

In relative terms, our expectation for Assaí's revenue should outperform its main competitor Atacadão (23.2% y/y Assaí vs. 5.1% y/y Atacadão; SSS of -1.5% y/y Assaí vs. -7.7% y/y Atacadão).

Both *atacarejo* players had a promotional campaigns in mid-April and May this year. We believe that Atacadão has adopted a more aggressive pricing strategy than Assaí, given the anniversary campaign in April ("Dia A").

In our view, gross margins from converted stores will partially offset the competitive environment in the Southeast region, allowing for price investment in other regions.

We expect **Assaí to post a stable gross margin y/y at 16.1%**, but a significant -50bps compression in adjusted EBITDA margin, given lower operating leverage and pre-operational impacts from stores that are still in the process of conversion.

Finally, we estimate a net profit of R\$ 161 million (-49.7% y/y) and a net margin of 1.0%. Below, we have gathered our expectation for Assaí in 2Q23 (see Table 3).

Table 3: Genial estimates for Assaí in the 2nd quarter.

ASSAÍ	2Q23 E	2Q22 C	% y/y bps	Bloomberg Cons.*	% Genial / Bloomberg	1Q23 C	% q/q bps
Gross Sales	17.656	14.530	21,5%	N/A	-	16.567	6,6%
Same Store Sales (%)	-1,4%	14,7%	-	N/A	-	7,2%	-
Net Revenue	16.151	13.291	21,5%	16.918	-4,5%	15.096	7,0%
COGS	(13.544)	(11.146)	21,5%	(14.198)	-4,6%	(12.668)	6,9%
Gross profit	2.607	2.145	21,5%	2.720	-4,2%	2.428	7,4%
% Gross margin	16,1%	16,1%	0 bps	16,1%	6 bps	16,1%	6 bps
EBIT	753	709	6,2%	827	-9,0%	619	21,7%
% EBIT margin	4,7%	5,3%	-67 bps	4,9%	-23 bps	4,1%	56 bps
Depreciation and Amortization	(341)	(213)	60,2%	(311)	9,8%	(313)	9,1%
Adj. EBITDA	1.111	978	13,6%	1.138	-2,4%	951	16,8%
% Adj. EBITDA margin	6,9%	7,4%	-48 bps	6,7%	15 bps	6,3%	58 bps
Net financial expenses	(645)	(328)	96,8%	N/A	-	(630)	2,4%
Income Tax	53	(62)	-185,2%	N/A	-	83	-36,3%
Net Income	161	319	-49,7%	123	30,1%	72	123,0%
% Net margin	1,0%	2,4%	-141 bps	0,7%	26 bps	0,5%	52 bps

* Retrieved on Jul 10. 2023

Part II: New estimates

Considering the **(I)** increased industry competition in the southeast region, **(II)** the impact of food disinflation and **(III)** the failure to achieve the guidance of R\$100 billion in 2024, previously foreseen, we are updating our outlook for Assaí.

Regarding item **(III)**, we need to clarify some points. Given a still restrictive interest rate environment, with the Selic Est. Genial target at 12.75% at the end of 2023 and 11.00% by the end of 2024 ([see macroeconomic projections here](#)), and given the company's high financial leverage (~2.8x DL/EBITDA pre-IFRS 16), we believe Assaí should moderately slow down the pace of organic opening for 2023 and 2024 - we estimate opening 15 and 10 units, respectively, in the years.

When we add the vector of lower organic expansion growth to the deceleration of food inflation, still without recomposition of items in the basket, we believe that Assaí should not comply with the guidance previously proposed. **We are incorporating a more pessimistic outlook for the short term and we understand that the R\$ 100 billion level should be delayed by 2 years, to 2026.**

Assuming a cost of equity (Ke) of 15.7% and a perpetuity growth (g) of 3.0%, and through a discounted cash flow (DCF), **we are cutting the 2023E target price from R\$20 to R\$17** - upside of 40% from the price on 19/Jul. Below we perform a target sensitivity and in all scenarios we see a significant upside for the paper.

		Cost of Equity (Ke)				
		12,7%	14,2%	15,7%	17,2%	18,7%
g	1,0%	17,2	16,9	16,6	16,3	16,1
	2,0%	17,5	17,1	16,8	16,5	16,3
	3,0%	17,8	17,4	17,0	16,7	16,4
	4,0%	18,2	17,7	17,3	17,0	16,7
	5,0%	18,7	18,2	17,7	17,3	16,9

		Cost of Equity (Ke)				
		12,7%	14,2%	15,7%	17,2%	18,7%
g	1,0%	41,6%	15,8	36,4%	34,3%	32,5%
	2,0%	43,9%	40,9%	38,2%	35,9%	33,9%
	3,0%	46,7%	43,3%	40,3%	37,7%	35,4%
	4,0%	50,1%	46,2%	42,8%	39,8%	37,3%
	5,0%	54,2%	49,7%	45,8%	42,4%	39,5%

The short term will be challenging and we believe ASAÍ's screen price today already incorporates this. Past the Casino overhang, which no longer has a position in the group, and trading at 11x P/E 2024 Est. Genial (18% below historical average), we maintain Assaí with a **BUY recommendation** and reiterate it as a top pick in food retail.

With no standard rate even defined, **we are not yet incorporating any impact from the Tax Reform** - passed in Congress on Friday (7/Jul) and currently under discussion in the Senate.

What tax benefit is Assaí exposed to? ICMS incentive. Tax incentives granted by the states are now considered investment grants, deductible for the calculation of income tax and social contribution. The company has been recovering these credits through the authorization for immediate compensation, due to its operations, obtaining a special regime and other procedures regulated by state rules.

In 2022, the company recognized a tax incentive (ICMS subsidy - Law No. 12,973/14 and Law 160/17) of R\$ 248 million, reducing the **effective rate to 8.6% in the year**, and allocated the amount of R\$ 753 to tax incentive reserve. In 1Q23 data, the group has R\$ 1.85 billion of Taxes that it expects to recover over the next 10 years (inc. ICMS, PIS/COFINS and INSS). The expectation is to recover R\$ 1.01 billion already in the next 12 months.

Table 4: Genial estimates for Assaí in 2023, 2024 and 2025.

Consolidated group	2022	2023 E			2024 E			2025 E		
	Consolidated	New	Old	% Change	New	Old	% Change	New	Old	% Change
Gross Sales	59.661	75.584	89.791	-15,8%	87.690	103.065	-14,9%	97.063	113.328	-14,4%
	4,9%	13,6%	24,9%	-1128 bps	12,9%	9,0%	394 bps	7,1%	4,7%	246 bps
Same Store Sales (%)	54.520	68.999	82.428	-16,3%	80.049	94.536	-15,3%	88.606	103.991	-14,8%
Net Revenue	(45.557)	(57.738)	(68.805)	-16,1%	(66.910)	(78.679)	-15,0%	(73.973)	(86.289)	-14,3%
COGS	8.963	11.261	13.623	-17,3%	13.140	15.857	-17,1%	14.634	17.701	-17,3%
Gross profit	16,4%	16,3%	16,5%	-21 bps	16,4%	16,8%	-36 bps	16,5%	17,0%	-51 bps
% Gross margin	2.850	3.648	4.054	-10,0%	4.396	5.008	-12,2%	5.005	5.933	-15,6%
EBIT	5,2%	5,3%	4,9%	37 bps	5,5%	5,3%	19 bps	5,6%	5,7%	-6 bps
% EBIT margin	(919)	(1.241)	(1.342)	-7,5%	(1.382)	(1.415)	-2,3%	(1.468)	(1.471)	-0,2%
Depreciation and Amortization	3.912	4.962	5.396	-8,0%	5.858	6.422	-8,8%	6.562	7.403	-11,4%
Adj. EBITDA	7,2%	7,2%	6,5%	65 bps	7,3%	6,8%	52 bps	7,4%	7,1%	29 bps
% Adj. EBITDA margin	(1.515)	(2.800)	(1.701)	64,5%	(2.882)	(1.373)	109,9%	(2.862)	(1.104)	159,4%
Net financial expenses	(115)	77	(641)	-112,0%	(132)	(997)	-86,8%	(343)	(1.330)	-74,2%
Income Tax	1.220	925	1.711	-46,0%	1.382	2.638	-47,6%	1.800	3.500	-48,6%
Net Income	2,2%	1,3%	2,1%	-74 bps	1,7%	2,8%	-106 bps	2,0%	3,4%	-133 bps
% Net margin										

Disclaimer

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Genial Rating

	Definition	Coverage
Buy	Expected return above +10% in relation to the Company's sector average	46%
Neutral	Expected return between +10% and -10% relative to the Company's industry average	44%
Sell	Expected return below -10% in relation to the Company's sector average	5%
under Review	Under review	5%

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